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BRIEFING NOTE TO THE MINISTER OF INFRASTRUCTURE AND COMMUNITIES


UPDATE ON THE CANADIAN CONSTRUCTION INDUSTRY

(For Information)

PURPOSE

To provide an update on Canadian construction industry and the impacts of COVID-19.

SUMMARY

- Like other industries, the downturn in the economy is expected to impact the construction industry in the near term, with the effects dependent on exposure to projects under delay.
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- Over the past few weeks, officials have been engaged with construction firms, associations, and other governments to better understand the current situation on construction sites specifically and the potential near-term effects of the pandemic on the public infrastructure part of the industry, and what the longer term implications may be for health and safety and social distancing practices.
- Many support programs introduced by the Government will benefit construction companies and related suppliers and sub-contractors. These include financial measures to support liquidity and lending through financial institutions through to direct support via EDC or BDC, and wage and income support measures.
- The unique cost and risk drivers for construction firms will be the overruns and delays on current projects under construction, and how those costs are financed and shared with public or private owners, depending on contract terms.
- As for public infrastructure projects, the ability to restart and support an economic rebound will depend on the ability to preserve industry capacity, including the workforce, firms and financing available to continue build public infrastructure now and in the future.

PROTECTED B**CONTEXT AND KEY FACTS**

- The approach to construction as an essential service differs by each province and territory. In some areas such as Quebec and Northwest Territories, there has been a complete shutdown, where in other such as British Columbia and Ontario, work continues onsite.
- Where sites are open there has been a loss of productivity to due labour shortages or reduced number of employees reporting to work, as well as disruptions in the supply chain. There will be costs associated with the delays and some of which can be mitigated depending on stage of project, whereas others face increased costs.
- The sharing of these costs as an impact of the current situation has provoked concern about the construction industry's ability to withstand the financial impacts of the pandemic, without support and fair treatment of risk sharing.
- The length of time of the disruption will be a key determinant, as well as the interpretation of the contract terms on how such delays are treated. And how companies, big and small, as well as supply chain take advantage support programs. See lists of Canada's top construction firms in **Annex A** and engineering in **Annex B**. See **Annex C** for how existing announcing support measured may be benefit these firms.

Financial Impacts

- How construction firms are financed can differ depending on the size of the firm and its role in a particular project. In the case of the larger firms, they may have the balance sheet to carry the financing themselves in advance of payment for the work carried out.
- Small and Medium Enterprises (SMEs) may, in some cases have the balance sheet to self-finance small projects, but in most cases, will draw down on their business and in some cases personal lines of credit to finance the supplies and equipment needed to begin construction.
- Projects would be backed by a surety bond or insurance from companies [REDACTED]
[REDACTED] These surety bonds ensure the contractors can meet the obligations to their clients.

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- A small number of larger firms, [REDACTED] [REDACTED] are publicly traded companies who will, in addition to the disruptions to their productivity, need to contend with the volatility of the markets and respond to their shareholders.
- Many of these firms will benefit from reduced salaries by furlough or temporary lay-offs, and wage subsidy programs, and will reduce variable costs as much as possible during the stress period. Then will rehire later.
- [REDACTED] These larger firms may be able to draw on bank liquidity lines or issue short term and longer term commercial paper, which are supported by Bank of Canada open market operations.
- Smaller firms are more reliant on bank lending and credit lines and some cases support from larger parents as important sub-contractors to remain solvent for an extended duration. Both large and small firms will need reasonably sound balance sheets to take on new volume of work.
- In some provincial markets the labour force was showing signs of being over extended or at maximum capacity prior to the pandemic, which was leading to calls for triage and sequencing projects in pipelines. Capacity concerns resurfacing could also aggravate the situation and impact ability to take on new projects or particularly larger ones over the short term until supply adjusts to demand.

Public-Private Partnerships

- While concern has been expressed by stakeholders about the livelihood of the construction industry writ-large, the concern over companies involved in Public-Private Partnerships (P3s) has highlighted some unique situation that occurs where private financing is involved.
- As the consortium of companies (Project Co.) involved in the design and construction must finance the project on its own during construction, projects where there are delays or stoppages will put financial pressure on their financial situation. While there are many advantages to P3 models and risk transfer if risk allocation is not done properly then debt and equity financiers may be harmed, and could deter them from financing future projects in near term.

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- During construction Project Co. will have begun to draw down on its long-term debt as well as the short-term debt during the construction period. Depending on the nature of the Force Majeure or Relief Events clauses in the contract or Project Agreement, the amount of compensation and relief may vary.
- A delay of reaching the end of construction or Substantial Completion, delays the payment from the public sector owner to the private partner. Depending on the size and makeup of the companies involved and their financial situation will impact their viability.
- The length of time to determine the contract terms and reach agreement with the public project authority is also a concern for these types of projects. This is why the associations, companies and financiers are supportive of raising these issues as a group to initiate discussions and gain further certainty on how issues will be handled.

Stakeholder views

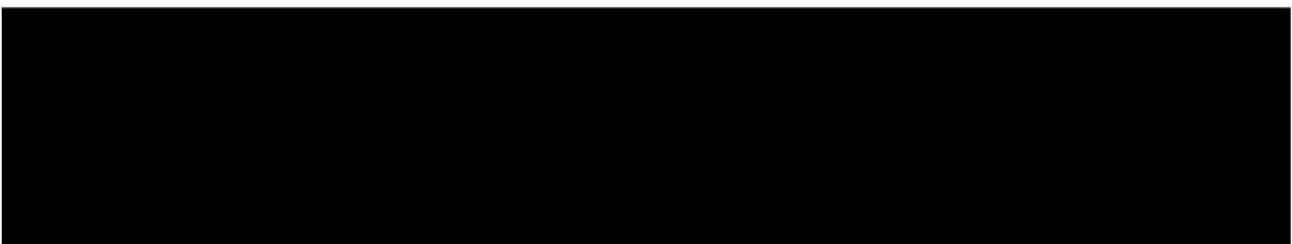
- The construction industry employs more than 1.5 million Canadians and is made up of 70% small- and medium-sized enterprises (SMEs) that build both public and private infrastructure across the country. Many of these entities work in a cross section of industries and sectors as well, as public infrastructure is only one part.
- In a letter to Minister Morneau, the Canadian Construction Association has expressed concern that the criteria for eligibility for the wage subsidy program may be too restrictive for the construction industry as the adverse impact of COVID-19 may take time to be realized in the industry.
- In general, under various labour models, some who work on projects are not employees of the construction firm, the construction companies therefore need to rely on partnerships with the building and non-building trades. The impact on employees under these arrangements would be outside of the firms' ability to support employees through the current programs.
- However, in their letter to the Minister of Finance, the CCA notes that revenue reduction in the construction industry may not occur in the short-term and that "the nature of the industry is such that there is generally a lag between events or leading indicators on one hand and economic impacts to the industry". While sub-contractors may be an immediate concern for the industry, programs exist to support many. However the true impact of the pandemic may not be realized in the construction for many months and will depend on the length of the current measures to reduce the spread of the virus.

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- The Future of Infrastructure Group as well as the Canadian Council for Public Private Partnerships have encouraged governments to consider broad based initiatives at federal and provincial level to cover cost overruns attributed to COVID-19 and to avoid long litigious battles over costs, and contract interpretations over force majeure or relief events related to excusable delays and works changes in law.

CONSIDERATIONS

- The type of contract will determine the allocation of risks and costs between contractors and the owner of the project, such as public procurement authority.
- These contracts vary across Canada and how they are triggered will be dependent on the provincial or territorial context.
- Many of these projects would have had delays or cost overruns as a matter of course, and would need to separate COVID 19 costs from other delays and costs prior to the disruption.
- While there will most certainly be costs and delays for active projects, public authorities will work to minimize these costs and ensure all mitigation measures have been deployed.



- The impact could be felt also beyond contractors but investors and lenders such as in P3 contractors or others who provide capital to construction companies.

Economic Response Plan

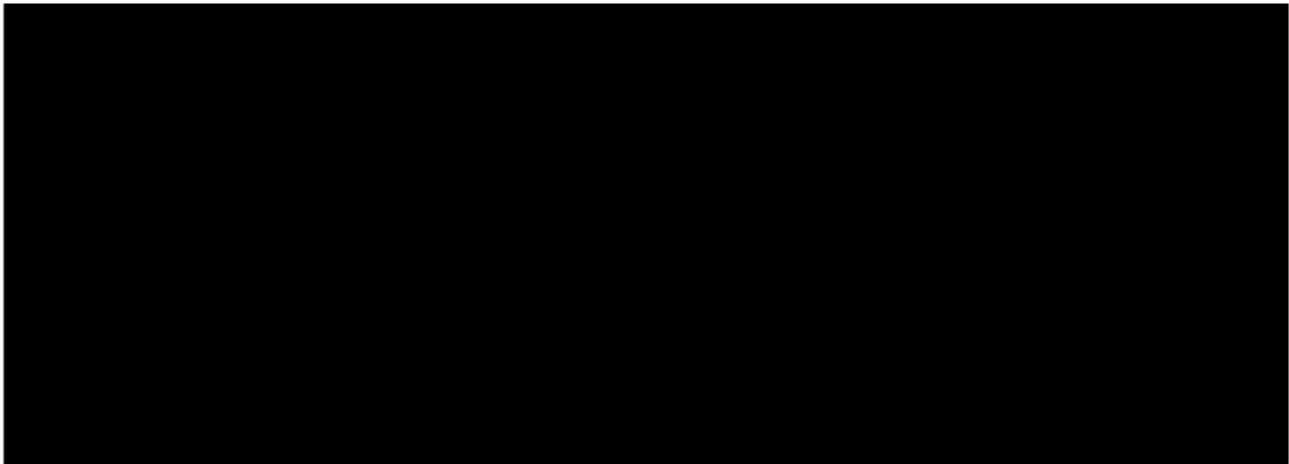
- The initiatives that target Canadian workers and businesses fall into six categories of support:
 - Avoiding layoffs and rehiring employees;
 - Access to credit;
 - Deferred payments;

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- Support for self-employed individuals;
 - Indigenous businesses; and
 - Supporting financial stability.
- A number of initiatives already announced or planned included under the above themes, would directly support Canadian construction companies. However, eligibility for some initiatives depends on the size of the company as a key criteria.

NEXT STEPS

- Officials will continue to monitor the market and provide updates as required.



Kelly Gillis
Deputy Minister
Infrastructure and Communities

Date

Attachments:

Annex A – Canada's Top 40 Construction Firms
Annex B – Canada's Top Engineering Firms
Annex C – Economic Response Plan initiatives of benefit to the construction industry

Annex A Top 40 construction companies in Canada

| Company: | 2018 Estimated Revenue (in billions) | Number of employees |
|---------------------------------|---|--------------------------------------|
| SNC-Lavalin Group Inc. | \$9.80 | 52, 435 |
| PCL Construction Inc. | \$9.00 | 4,400 (+ 10,000 hourly tradespeople) |
| EllisDon Corp. | \$3.90 | 2,500 |
| Aecon Group Inc. | \$2.30 | 10,600 |
| Graham Group Inc. | \$2.20 | 900 |
| Pomerleau Inc. | \$1.90 | 4,000 |
| Ledcor Group of Companies | \$1.90 | 6,000 |
| Kiewit Canada Group Inc. | \$1.50 | 22,000 |
| Bird Construction Inc. | \$1.40 | |
| EBC Inc. | \$1.10 | 2,800 |
| Stuart Olson Inc. | \$1.00 | 3010 |
| Flynn Group of Companies | \$0.90 | 5000 |
| Broccolini | \$0.60 | 40 |
| Clark Builders | \$0.60 | 770 |
| Turner Construction Co. | \$0.55 | 5,200 |
| Axion Builders Inc. | \$0.55 | 350 |
| Reliance Construction Group | \$0.55 | |
| The State Group Inc. | \$0.50 | 1,100 |
| The Taggart Group of Companies | \$0.45 | |
| North American Construction Gro | \$0.40 | |
| Chandos Construction | \$0.40 | |
| Pennecon Ltd. | \$0.37 | |
| ConDrain Group | \$0.35 | |
| Dawson Wallace Construction | \$0.30 | |
| Govan Brown & Associates Ltd. | \$0.26 | |
| FWS Group of Companies | \$0.24 | |
| Delmor Constrction Ltd. | \$0.20 | |
| Claridge Homes | \$0.20 | |
| Buttcon Ltd. | \$0.18 | |
| Wales Mclelland Construction | \$0.17 | |
| Avondale Construction Ltd. | \$0.16 | |
| Metro-Can Construction Ltd. | \$0.15 | |
| Walsh Canada | \$0.15 | |
| Bockstael Construction Ltd. | \$0.15 | |
| Keller Foundations Ltd. | \$0.14 | |
| M Builds Construction | \$0.13 | |
| Filmore Construction | \$0.13 | |
| Acadian Construction | \$0.12 | |
| Leewood Construction | \$0.11 | |
| Scott Construction Group | \$0.11 | |

Annex B Top 15 engineering companies in Canada

- Aecon Group Inc.
- Bantrel Co.
- Canadian Natural Resources (CNRL)
- CIMA+
- GHD Group
- EllisDon
- Exp
- WSP Global Inc.
- Golder Associates Inc.
- Hatch Group
- McElhanney
- Morrison Hershfield
- PCL Construction
- SNC-Lavalin
- Stantec

Annex C Measures to Support Construction Sector

| Initiative Name: | Support Provided: | Company Size: | Conditions: |
|--|---|---|---|
| Bank of Canada Corporate Bond Purchase Program (CBPP) | purchase eligible corporate bonds in the secondary market | - | program capped at \$10 billion; restricted to senior secured and unsecured bonds originated by Canadian incorporated companies; remaining maturity of 5 years; minimum credit rating of BBB or equivalent; deposit-taking intuitions debt is excluded; expected to be operational mid-May |
| OSFI Adjustment to the Domestic Stability Buffer (DSB) | Lowering of the DSB by 1.25% of risk weighted assests to 1.00% | - | supports in excess of \$300 billion of additional lending capacity by domestic systematically important banks (D-SIBs) to support Canadian businesses and households; dividend increases and share buybacks to be halted |
| Enhanced Wage Subsidy | 75% of employee's wages; 100% refund for certain employer contributions such as EI | All | gross revenue drop of at least 15% in March and 30% in April |
| Temporary 10% Wage Subsidy | 3-month reduction on payroll deductions remitted to CRA | Canadian-controlled private corporation eligible for small business deduction | have existing business number and payroll program account with the CRA on March 18, 2020 and pay salary, wages, bonuses, or other remuneration to an eligible employee |
| Work-sharing Program | extension of the maximum duration from 38 to 76 weeks to provide income support to employees eligible for EI who agree to reduce their normal working hours | All | |

Annex C Measures to Support Construction Sector

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| Deferred Income Tax Payments | defer income tax payments owing until after August 31, 202 | All | only for amounts owing on or after March 18 and before September 2020 |
| Deferred Sales Tax Remittance and Customs Duty Payments | defer payments of GST/HST as well as customs duty owing on imports until June 30, 2020 | All | GST/HST owing from March 27 until end of May can be deferred until the end of June; GST and customs duty payments for imported good for March, April and May |
| Business Credit Availability Program (BCAP) | | | |
| Canada Emergency Business Account | interest-free loans of up to \$40,00 to help cover operating costs | Small businesses and not-for-profits | Employers with \$20,000 to \$1.5 million in total payroll in 2019 and operating as of March 1, 2020; Financial institutions to provide up to \$40,000 in interest-free credit facilities; loans repaid by December 31, 2022 will; have 25% up to \$10,00 forgiven; if not repaid, balance will be converted to a three-year term loan at 5% |
| Loan Guarantee | up to \$6.25M in new operating credit and cash flow terms | SMEs (fewer than 500 employees) | Available to all Canadian businesses in all sectors that were otherwise financially viable and revenue-generating prior to the COVID-19 outbreak; loans are 80% guaranteed by EDC; money can be used for operational expenses but not for dividend payouts, shareholder loans, bonuses, stock buybacks, option issuance, increases to executive compensation or repayment/refinancing of other debt. |

Annex C Measures to Support Construction Sector

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| Co-lending Program | loans of up to \$312,500 to business with revenues of less than \$1 million; up to \$3.125 million for businesses with revenue between \$1 million and \$50 million; and up to \$6.25 million for businesses with revenues in excess of \$50 million | All | Available to all Canadian businesses in all sectors that were otherwise financially viable and revenue-generating prior to the COVID-19 outbreak and provides term loans for operational and liquidity needs which can include interest payments on existing debt. Loans are interest-only for first 12 months with a 10-year repayment period. |
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